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Supreme Court of the United States

October Term, 1933.

No. 703. 14

HANDY & HARMAN,

Petitioner,

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONER.

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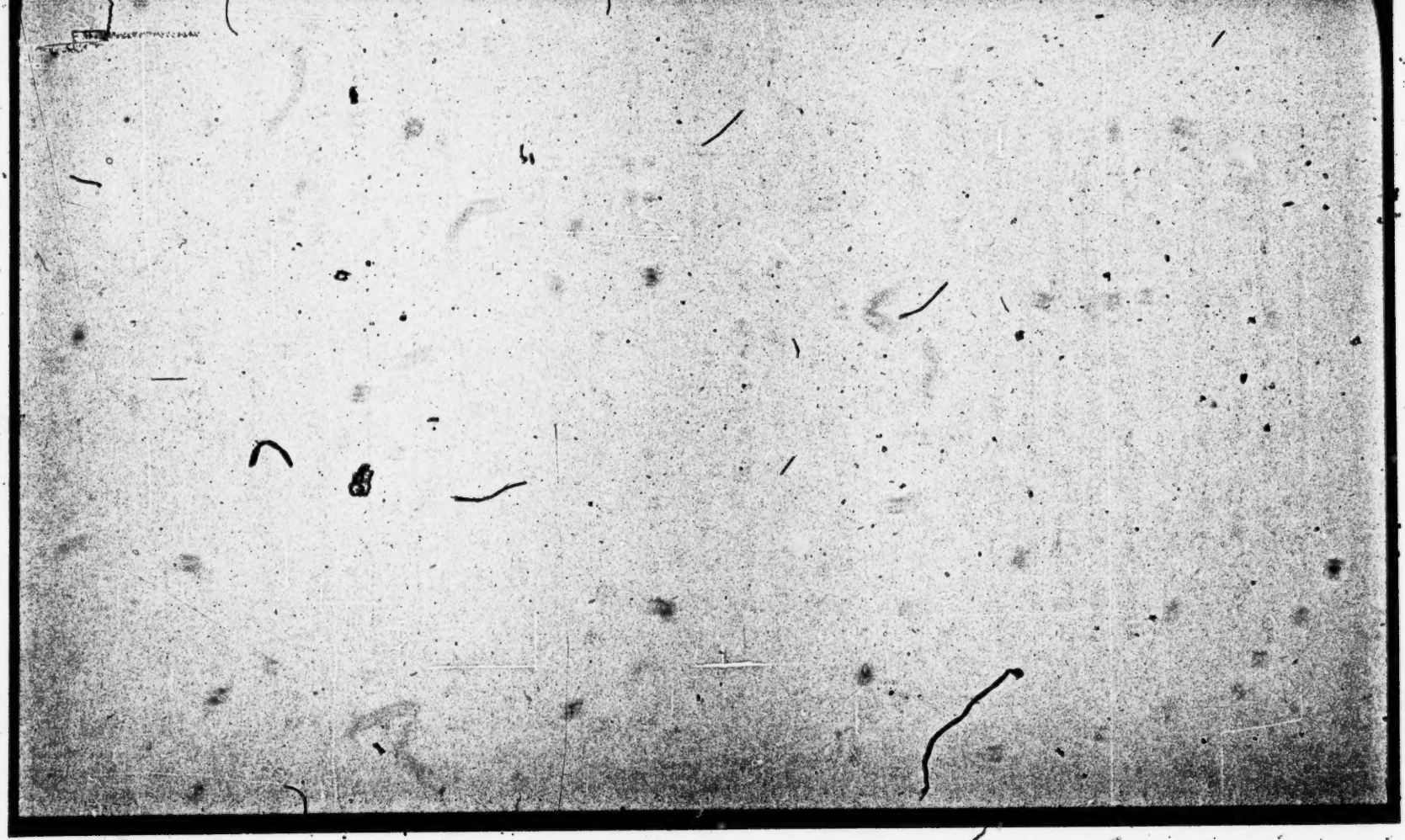

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Supreme Court of the United States

OCTOBER TERM, 1930.

No. 709.

HANDY & HARMAN, Petitioner,

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Respondent.

BRIEF FOR PETITIONER.

Previous Opinions.

The previous opinions in this case are those of the United States Board of Tax Appeals, 17 B. T. A. 980, and the United States Circuit Court of Appeals for the Second Circuit (R. 45-49).

Jurisdiction.

This case involves income and profits taxes for the calendar year 1918 in the amount of $79,919.93 and for the year 1919 in the amount of $3,156.90 (R. 6, 12). The case comes before this court on writ of certiorari issued March 16, 1930, to review the decision of the United States Circuit Court of Appeals for the Second Circuit (R. 50).

Statement.

The petitioner, Handy & Harman, claimed the right to file consolidated returns of net income and invested capital with Hamilton & DeLoss, Inc., for the year 1918 and the period January 1 to February 1, 1919, upon the ground that the two corporations were affiliated within the meaning of Section 240 of the Revenue Act of 1918.

In 1920 the then Commissioner of Internal Revenue ruled that the two companies were so affiliated and accepted the consolidated returns. Subsequently in 1924 Commissioner Blair reversed the ruling of his predecessor, held the two companies not affiliated, rejected petitioner's claims for abatement for 1918, and asserted a deficiency for 1919 (R. 21). The United States Board of Tax Appeals approved the determination of the Commissioner (R. 16-24). Upon petition for review the United States Circuit Court of Appeals for the Second Circuit affirmed the decision of the Board of Tax Appeals (R. 45-49).

Handy & Harman, a New York corporation, was organized in 1905 and succeeded to the business of the partnership of Handy & Harman which for many years had been engaged in dealing in gold and silver bullion and specie. The petitioner has its principal office in New York City and its factory is located at Bridgeport, Connecticut (R. 17).

Prior to 1906 the petitioner and the partnership had been supplying the silversmith trade with silver rolled into sheets and coils, but about that time the petitioner began the practice of cutting the silver into flat circles and rectangles, thereby effecting certain economies in investment and operation. About 1912 or 1913 the officers of petitioner conceived the idea of not only stamping out the flat circles and rectangles but of partially shaping them, thereby effect-

ing further economies to themselves and to the trade. This operation would have required the installation of additional machinery by the petitioner and the question of whether this work should be handled by the petitioner or by a separate corporation was discussed and considered by the officers of petitioner for several years. Finally it was decided to form a new corporation for that purpose. Accordingly, on December 23, 1916, the new corporation, Hamilton & DeLoss, Inc., was organized under the laws of Connecticut. It was the intention of the officers of both corporations that Handy & Harman should continue to mill and roll the silver, but that Hamilton & DeLoss, Inc., should take over all of the stamping department operations (R. 17-18).

Hamilton & DeLoss, Inc., erected a plant in Bridgeport within 150 yards of the plant of Handy & Harman, and silver production machinery costing $47,000 was installed. However, because of war conditions, work was slow and at the end of January, 1918, the output of the plant had been small, the total sales amounting to approximately $6,000 (R. 19).

At the beginning of the year 1918 the silver business had declined greatly and it was difficult to obtain labor and raw material. Furthermore, the officers were apprehensive that both corporations, being classified as non-essential industries, would be taken over by the Government and disorganized. After considerable discussion among the officers and directors of both corporations it was decided that Hamilton & DeLoss, Inc., should not continue for the present with the silver stamping business for which it had been organized and equipped. In order to continue the plant in operation it became necessary to secure contracts from the Government. The petitioner also secured some

Government contracts which were of benefit in placing it among the essential industries of the country (R. 19-20).

In 1918 an officer connected with the Gas Mask Division of the United States Army called on Mr. DeLoss at the plant of Handy & Harman in Bridgeport to ascertain whether that plant could mill brass for making eye-pieces for gas masks and in addition stamp out the eye-pieces. DeLoss informed him that since the plant of Handy & Harman was not equipped to stamp out the eye-pieces, the entire work could not be done by petitioner alone, but that the work could be done by utilizing the plants of both Handy & Harman and Hamilton & DeLoss, Inc. The question of accepting this contract was discussed among the officers and directors of the two corporations, and it was finally decided to take the contract. Since the billing work could be more conveniently handled through the offices of Hamilton & DeLoss, Inc., the contract was actually taken in the name of that corporation. The petitioner, however, financed the contract, and as in its silver business milled and rolled the metal and furnished it to Hamilton & DeLoss, Inc., which stamped out the eye-pieces and returned the scrap metal to petitioner for remelting. The entire work was performed in that manner, neither plant being equipped to do the work independently of the other. Neither the petitioner nor Hamilton & DeLoss, Inc., made any profit from the eye-piece contract. Hamilton & DeLoss, Inc., sustained a net loss in the year 1918 and during the month of January, 1919 (R. 20-21).

Prior to the organization of Hamilton & DeLoss, Inc., Harry H. DeLoss, vice-president of the petitioner, had discussed the question of the formation of such corporation at great length with Harold H. Hamilton, who had had many years experience in the silversmithing business, and

when it was finally decided to form a new corporation Hamilton was invited to become its head (R. 18). However, he had no money with which to purchase stock therein and the stock originally issued in his name was financed through arrangements made by DeLoss whereby the necessary money was borrowed from a bank upon notes endorsed by DeLoss (R. 19). Prior to the beginning of the taxable periods in question Hamilton executed an "irrevocable stock power" assigning his stock in Hamilton & DeLoss, Inc., to one Robert M. Higgins (R. 38), who, nine days after the beginning of the taxable period, executed a similar instrument assigning and transferring the stock to DeLoss (R. 37), who deposited it with the bank as collateral security for the notes. Hamilton never paid anything upon the notes. In 1919 he became insolvent and on February 1, 1919, DeLoss paid the notes and the stock was returned to him by the bank. Prior to the last mentioned date Hamilton attended all stockholders' meetings of Hamilton & DeLoss, Inc., but never voted in opposition to the men who owned the majority stock of both corporations (R. 19).

Hamilton received a salary of about $10,000 a year from Hamilton & DeLoss, Inc. However, its other officers and directors, who were also officers, directors or employees of Handy & Harman, received their compensation solely from the latter corporation although all or a large part of their working hours were devoted to the business of Hamilton & DeLoss, Inc. (R. 19).

At all times during the taxable periods involved six men, Messrs. Parker D. Handy, John L. Harman, Harry H. DeLoss, William B. Sewell, George C. Gerrish and Robert H. Leach owned outright 93.71 per cent of the capital stock of Handy & Harman, the remaining shares being owned by employees and most of said shares held subject to the con-

poration's option to repurchase should the shareholders leave its employ. The same six men also owned 76.66 per cent of the stock of Hamilton & DeLoss, Inc., while 20 per cent of its stock was originally issued to Harold H. Hamilton, and later assigned and delivered to DeLoss as stated above (R. 18-19).

The issue arises under the subdivision of Section 240(b) of the Revenue Act of 1918 providing that corporations shall be deemed affiliated "if substantially" all of the stock of two or more corporations is *owned or controlled* by the same interests."

The Circuit Court denied to petitioner the right to file affiliated returns with Hamilton & DeLoss, Inc., upon the grounds that although DeLoss and his associates exercised *actual* control over the stock originally issued to Hamilton, this control was not based upon legally enforceable means, and therefore the requirements of the statute had not been met (R. 48-49).

Specification of Errors.

The Circuit Court of Appeals erred in holding:

1. That the control of stock referred to in the statute means a control based upon legally enforceable means and not control in fact or actual control.

2. That Handy & Harman and Hamilton & DeLoss, Inc., were not affiliated corporations and not entitled to make consolidated returns of net income and invested capital for the period January 1, 1918 to February 1, 1919.

ARGUMENT.

I.

The requirements for affiliation contained in Section 240(b) of the Revenue Act of 1918 are met if substantially all the stock of two or more corporations is owned or *actually* controlled by the same interests, whether or not such control is based upon legally enforceable means.

The petitioner's claim for affiliation with Hamilton & DeLoss, Inc., arises under Section 240 of the Revenue Act of 1918 (40 Stat. 1057).

The pertinent provisions of the law are as follows:

> "Sec. 240 (a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon the basis of such return:
>
> * * * * * *
>
> (b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated * * * (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests."

This case comes before the court by reason of a conflict between the Circuit Courts of Appeals with respect to the meaning to be given to the word "controlled" as used in Section 240(b), *supra*.

The court below has adopted the narrow view of the statute and has held:

> "That if 'control' means something different from ownership of stock, it must at least be a control legally enforceable" (R. 48).

This view is opposed to the construction placed upon the word "controlled" by the Circuit Courts of Appeals of five other circuits.

Petitioner contends that the interpretation adopted by the Second Circuit is erroneous, and that where two or more corporations are operating as a business and economic unit, *actual* control of the stock of the minority is sufficient whether or not based upon legally enforceable means. The decisions sustaining this view are as follows:

Kile & Morgan Co. *v.* Commissioner, 41 F. (2d) 925, C. C. A. 1;

J. Rogers Flannery & Co. *v.* Commissioner, 42 F. (2d) 11, C. C. A. 3;

Pelican Ice Co. *v.* Commissioner, 37 F. (2d) 285, C. C. A. 5;

Great Lakes Hotel Co. *v.* Commissioner, 30 F. (2d) 1, C. C. A. 7;

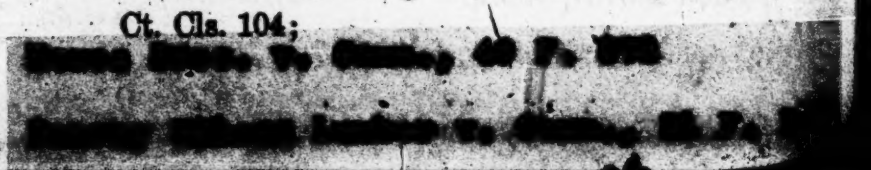
Commissioner *v.* Wilshire Oil Company, Inc., C. C. A. 9, decided Feb. 9, 1931;

Commissioner *v.* Richfield Oil Co., 42 F. (2d) 360, C. C. A. 9;

Mahoning Coal Railroad Co. *v.* U. S., 41 Fed. (2d) 533;

Eby Shoe Co., Inc. *v.* United States, 44 F. (2d) 273 (Ct. Cls.);

Ullman Manufacturing Co. *v.* United States, 67 Ct. Cls. 104;



Appeal of Hagerstown Shoe and Legging Co., 1 B. T. A. 666;
Appeal of Isse Koch & Co., Inc., 1 B. T. A. 624.

In the case before this court it has never been questioned that petitioner and Hamilton & DeLoss, Inc., were a business and economic unit and were operated as such. Upon its organization in 1916 Hamilton & DeLoss, Inc., took over the stamping department of the petitioner's business. Its plant was erected adjacent to the plant of petitioner, and, except for Hamilton, the officers and directors of the two corporations were the same. Their salaries, however, were paid entirely by petitioner. After the organization of Hamilton & DeLoss, Inc., the petitioner continued to finance the purchase of materials and to melt and roll the silver into sheets which were then turned over to Hamilton & DeLoss, Inc., to be stamped into the desired shapes. The gas mask contract which was secured in 1918 was taken in the name of Hamilton & DeLoss, Inc., merely for greater convenience in handling the bookkeeping. In performing this contract, as in its silver business, petitioner purchased the materials, melted and rolled the brass for the eye pieces, and furnished it to Hamilton & DeLoss, Inc., for stamping. Neither corporation was equipped to function without the aid of the other (R. 17-21).

Furthermore, six men owned or controlled substantially all of the stock of both corporations. Parker D. Handy, John F. Harman, Harry H. DeLoss, William B. Sewell, George C. Gerrish and Robert H. Leach together owned 93.71% of the stock of petitioner and controlled the remaining shares which were owned by employees and subject to petitioner's option to repurchase should the shareholder leave its employ. The same six men also

owned 76.66% of the stock of Hamilton & DeLoss, Inc. An additional 20% of the stock of this corporation stood in the name of H. H. Hamilton, who was not a stockholder in Handy & Harman. However, it is clear that the position of Hamilton was not that of an ordinary stockholder. He was merely an employee whose employment was at the will of the majority stockholders and not for a term. At no time during the taxable period did he have legal title to or possession of the stock standing in his name (R. 37-8). He was a man without means or credit and never had any capital invested in and subject to the risks of the enterprise (R. 19). The continued existence of harmonious relations between himself and the majority was imperative if he was to retain even the possibility of becoming a stockholder. Under such circumstances it is submitted that the majority stockholders completely dominated and controlled the voting power of the so-called Hamilton stock. Their control was such as to render it impotent and negligible as a possible adverse interest.

The court below conceded the existence of this actual control over the Hamilton stock but denied affiliation on the ground that the statute required a control based upon legally enforceable means. This interpretation is erroneous because it fails to apply the accepted meaning of the words of the statute and thus give effect to the intent of Congress.

The word "controlled" as it appears in the statute is unqualified. It is defined in Webster's International Dictionary as meaning: "To exercise restraining or directing influence over; to dominate; regulate; hence to hold from action; to curb, subject, overpower." In Funk & Wagnalls New Standard Dictionary it is defined as meaning "to exercise a direct, restraining or governing influence".

The word "owned" is not synonymous with "controlled", but is defined by Webster as meaning "to possess, to have a rightful title to, whether legal or natural".

As pointed out in the cases cited above:

> "Even though the word 'control', as used in the statute is interpreted to mean stock control, it was clearly not intended to be synonymous with stock ownership. If it were otherwise there would have been no purpose in using the words 'owned or controlled' in the statute" *Mahoning Coal Railroad Co.* v. *U. S., supra* (41 Fed. (2d) 533, 536).

However, the court below, in restricting the word "controlled" to a control based upon legally enforceable means, refused to give to the word its accepted meaning and made it practically synonymous with the word "owned".

Such a construction cannot be justified since "* * * statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributed to them". *DeGanay* v. *Lederer*, 250 U. S. 376, 381. The Legislature is presumed to have used no superfluous words, and every word of a statute must be accorded a meaning. *Platt* v. *Union Pacific Railroad Company*, 99 U. S. 48, 58-59. In construing taxing statutes it is most important that the words employed be given their literal meaning. *United States* v. *Merriam*, 263 U. S. 179, 187. Or as the rule is sometimes stated:

> "* * * the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."
>
> Lynch *v.* Alworth-Stephen Co., 267 U. S. 364, 370.

The interpretation of the court below violates all of these well-settled principles, while that urged by petitioner accepts and applies them. It is obvious that if these principles are applied and the words given their literal meaning, "control of stock" is something very different from "ownership of stock" and that the word "controlled" means *actual* control, whether or not based upon legally enforceable means.

Furthermore, the legislative history of the Act furnishes abundant evidence that Congress used these words in their broad and natural sense.

The first provision requiring or permitting the filing of consolidated returns was contained in Articles 77 and 78 of Treasury Regulations 41 issued by the Commissioner pursuant to the War Revenue Act of October 3, 1917 (40 Stat., 300). Article 77 provided in part as follows:

> "For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is *owned* by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital."

In subdivision 1 of the above article affiliation was deemed to exist "when substantially all of the stock of two or more corporations is *owned* by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business."

When H. R. 12863, which later became the Revenue Act of 1918, was under consideration in Congress, the Senate Finance Committee said the following in its report to the Senate with respect to the subject of affiliation:

> "Provision has been made in Sec. 240 for a consolidated return, in the case of affiliated corporations, for purposes both of income and profits taxes. A year's trial of the consolidated return under the existing law demonstrated the advisability of conferring upon the Commissioner explicit authority to require such returns.
>
> "So far as its immediate effect is concerned consolidation increases the tax in some cases and reduces it in other cases, but its general and permanent effect is to prevent evasions which can not be blocked in any other way. Moreover, a law which contains no requirements for consolidation, puts an almost irresistible premium on a segregation or a separate incorporation of activities which would normally be carried as branches of one concern. Increasing evidence has come to light demonstrating that the possibilities of evading taxation in these and allied ways are becoming familiar to the taxpayers of the country. While the committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because *the principle of taxing as a business unit is sound and equi-*

table and convenient both to the taxpayer and to the government." (Italics ours.)

Sen. Rep. 617 to accompany H. R. 12863, December 6, 1918, 65th Cong., Third Sess., pp. 8-9.

It is perfectly clear from the foregoing that in enacting Section 240 of the 1918 Act. Congress intended to make provision for levying the tax in accordance with the true net income and invested capital of an enterprise and to disregard the incidental placing of its different branches in legally separate corporations. The purpose sought to be accomplished was to prevent the evasion of taxes and to prevent a business unit from being subjected to undue taxes.

To make this intent effective, Congress used language in the 1918 Act which is materially broader in its meaning than that contained in the 1917 Regulations. The 1918 Act substituted the words "*owned or controlled*" for the word "*owned*". Under these circumstances it certainly cannot be presumed that Congress deemed the word "controlled" synonymous with the word "owned" or intended that the words "or controlled" should be disregarded or given a strained and unnatural meaning. To the contrary, it must be presumed that Congress, having deliberately substituted the phrase "owned or controlled" for the word "owned", intended that the word "controlled" be given its ordinary meaning. *Platt* vs. *Union Pacific R. R. Co., supra* (99 U. S. 48).

In order to further carry out this broad intent and purpose, Congress substituted the phrase "the same interests" for "the same individual or partnership", and eliminated the requirement that the businesses be the same or closely

related ones. It would be difficult to conceive of words better designed to give effect to the intention of Congress to tax as a business unit what in fact was a business unit.

Respondent has conceded that the language of the statute gives effect to this underlying purpose of Congress. Article 631 of Regulations 45 (1919 edition), issued by respondent under the Revenue Act of 1918, reads in part as follows:

> "Affiliated corporations.—The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. * * * Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. See articles 785, 791, 802 and 864-869."

This contemporaneous administrative interpretation of the Act is entitled to great weight.

> Swendig *v.* Washington Water Power Company, 265 U. S. 322, 331;
> Brewster *v.* Gage, 280 U. S. 327, 336;
> U. S. *v.* Jackson, 280 U. S. 183, 193.

In the Appeal of *Isse Koch & Co.*, 1 B. T. A. 624, 627, the Board of Tax Appeals construed Section 240 and held as follows:

> "There is no authority in the section of law referred to or in its context, so far as we can see, for assuming that Congress intended to use the word 'control' in other than its ordinary and accepted sense. On the other hand, we believe that a proper construction of the statute, if it is to serve the purpose for which it was intended, requires us to hold that the 'control' mentioned therein means actual control, regardless of whether or not it is based upon legally enforceable means."

Respondent acquiesced in this construction of the statute (Cumulative Bulletin, IV-I, p. 2).

Here, actual control of the Hamilton stock is conceded, but respondent now seeks to limit and restrict the natural meaning of the word "controlled" and deny petitioner the right to file consolidated returns with Hamilton & DeLoss, Inc., because the control was not based upon legally enforceable means.

In enacting the affiliation provisions of the 1918 Act, Congress admittedly sought to prevent the evasion of taxes by the arbitrary shifting of income "to one or another unit of the group" and at the same time to permit the tax to be levied upon the true net income of a single enterprise. As interpreted by the court below, the statute would not accomplish either of these purposes. It is submitted that the actual control of the Hamilton stock by the majority stockholders would be as effective for the purpose of the arbitrary shifting of income as a control based upon the most formal and legally enforceable instrument. Furthermore, during the taxable periods in question, the two corporations were engaged in a joint enterprise wholly unable to function independently. On the basis of separate returns, petitioner is subjected to an undue tax, for while it made a profit the stamping operations of Hamilton & DeLoss, Inc.,

were conducted at a loss. It is only by combining the operations of the inter-dependent companies in a consolidated return that the true net income and invested capital of the enterprise can be determined and the proper tax levied.

While the Government ought not to be deprived of its revenues through a strained and unnatural construction, it is equally clear the taxpayer should not be deprived thereby of the benefits which would flow to it from an interpretation which not only gives effect to the plain meaning of the words, but to the intent of Congress. The general application of the construction urged by petitioner will prevent the evasion of taxes and at the same time permit the tax to be levied upon the true net income of a single business enterprise.

II.

It is submitted that petitioner and Hamilton & DeLoss, Inc., were affiliated corporations within the meaning of Section 240 of the Revenue Act of 1918 and entitled to file consolidated returns of income and invested capital for the year 1918 and for the period of January 1, 1919 to February 1, 1919, and that the decision of the Circuit Court of Appeals holding the two corporations to be not affiliated for these periods should be reversed.

Respectfully submitted,

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